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291415Z Aug 05

C O N F I D E N T I A L SECTION 01 OF 04 NEW DELHI 006637

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DEPT PASS USTR FOR SOUTH ASIA - AWILLS/BSTILLMAN
DOE FOR TCUTLER AND DPUMPHREY
USDA FOR FAS/ITP/POMEROY/ARGUETA
USDOC FOR 3131 USFCS/OIO BORRR
USDOC FOR 4530/MAC/ANESA/OSA/LDROKER/ASTERN
USDOC FOR 6430/ITA/TD/ITI/KJENCI/EHOLLOWAY
TREASURY FOR SOUTH ESAT ASIAN NATIONS

E.O. 12958: DECL: 08/26/2015

TAGS: [PREL](#) [ECON](#) [ENV](#) [ENRG](#) [PGOV](#) [IN](#)

SUBJECT: THE SORDID PATRONAGE POLITICS OF ECONOMIC REFORM
IN INDIA: THE NATIONAL RURAL EMPLOYMENT GUARANTEE BILL

REF: A) 2004 NEW DELHI 3270 B) NEW DELHI 1522

Classified By: CLASSIFIED BY AMBASSADOR DAVID C. MULFORD FOR REASONS 1.
4 (B) AND (D)

11. (C) Summary and Introduction: On August 24, both Houses of Parliament passed the National Rural Employment Guarantee (NREG) Bill with little opposition by any political party. The Bill, which could theoretically cost the treasury as much as USD 70 billion over 5 years, will now go to President Kalam who is expected to sign it after a cursory review process, thus delivering a key element of the Common Minimum Program (ref A) adopted by the United Progressive alliance (UPA). The Bill was conceptualized by the National Advisory Council (NAC), the academic think tank chaired by Congress Party Chairperson Sonia Gandhi, who has championed its passage to establish Congress as the party that provides jobs to the poor. Congress party stalwarts clearly perceive it as a political necessity to "prime the pump" with state and local level party elements and key coalition partners in order to keep the coalition together and preserve the rural base that was key to their 2004 upset victory.

12. (C) Once passed, the NREG will become a platform to dole out funds to key constituencies -- but it is also expected to create enough jobs to create the semblance of progress among the rural poor. Even many friends of the Prime Minister concede that lack of delivery structures and mechanisms to assure accountability make it unlikely that whatever funds are actually spent will have a significant impact on employment or rural poverty alleviation. Moreover, the NREG is not even being portrayed as funding large projects, such as the Works Progress Administration did during the Depression. The benefit will instead accrue more to the politically needy (and savvy) and to rent-seekers than the economically needy. Nevertheless, Left parties and leftists inside Congress demanded passage of the NREG, and it became a pre-condition to forward movement on economic reform put forward by the "economists" in government, led by Prime Minister Singh. Singh has made delivery of the massive funding for the NREG conditional on sustained growth of eight percent. This will require further economic liberalization to which the Left has remained vehemently opposed. In India, the politics of bribery go hand in hand with the politics of economic reform, with real progress possible only if a balance can be struck between parochial party interests and reformist elements of the complicated NDA coalition.

13. (C) While driven mainly by Congress Party interests, the Left also supported the NREG Bill and will seek significant benefit in its own key constituencies, especially in Kerala and West Bengal, where the Left will compete with Congress in state elections in 2006. At worst, the jobs plan is political patronage run amok and horrid economic policy. In an ideal scenario, the Bill may provide the cover Congress party stalwarts and even the Left need tacitly to allow divestment of shares in state owned companies (septel) and partial opening up of the retail, insurance, pension market and agriculture sectors -- the GOI's top priorities. As Deputy Planning Commissioner Montek Ahluwalia has told us several times, once they break the bank, the leftists are going to have to help us find ways to pay for it all. End Summary and Introduction

GOI enacts Rural Employment Guarantee Bill

14. (C) The (NREG) Bill approved by both Houses of Parliament on August 24 fulfills a key element in the Congress-led government's Common Minimum Program. The scheme enables members of all rural households in 200 districts to get employment for 100 days a year to start with. Initially, the NREG would cost roughly USD 7.8 billion annually (one percent of GDP), rising to about double this amount if fully

implemented. The Prime Minister has stipulated, however, that funds will only be available if growth remains at eight percent and has equated this level of growth with progress on economic liberalization. Finance Minister Chidambaram has said the scheme will be funded through a combination of expenditure reduction (subsidies) and savings from existing employment schemes. Full implementation would severely compromise the GOI's Fiscal Responsibility and Budget Management targets unless real expenditure cuts are made elsewhere.

15. (C) As Embassy predicted when the UPA came to power, the new economic leadership is using the budget and budgetary "schemes" as the primary vehicle to force economic reforms. The center has introduced "conditionality" in most of its new budget allocations, especially to the states. This year, a "no scheme left behind" budget (ref C) is noteworthy for its effort to incentivize states to repeal antiquated and anti-competitive regulations, reduce subsidies, and improve fiscal management in exchange for access to central funding allocations. This is in fact working, with nine states now having repealed laws that inhibit development of private agricultural marketing networks. At the same time, the government is gradually tightening states' access to off-budget funds through local cooperative banks and constraining the use of guarantees to augment direct spending. In the medium term, the government is promoting the development of credit rating structures, combined with reduced allocations from the center, to enable those states and localities that successfully reform to tap debt markets. This process will take years to succeed. The NREG is clearly intended to placate the poor who perceive themselves as sharing unequally the benefits of reforms vis-a-vis India's burgeoning middle class, now estimated by the Indian Planning Commission to be growing at 40 million people per year (eight percent growth). Congress Party leaders led by Sonia Gandhi are pleading the case of the poor while economists in government are scheming to force the pace of economic reform.

Main provisions of the amended NREG scheme

16. (C) The key provisions of the NREG are:

100 days of wage employment a year for all rural households at a minimum wage of Rs 60 per day.

Initial roll out in 200 districts, expanding to 600 districts in the next five years.

Priority for women, with 33% of the total applicants reserved for women.

The center will contribute 90% of the funds for the scheme, while the states will bear the remaining 10%.

All implementation expenditure would be through a central employment guarantee fund and the government will also transfer funds to the state employment guarantee fund.

Government to pay compensation to the states in case funds are delayed, or jobs under the scheme are not provided.

The Panchayats would play the "principal role" in planning, implementation and monitoring of the employment schemes.

At BJP's insistence, Rural Development Minister Singh assured Parliament that the government may introduce another bill to ensure employment for urban households.

An "anti-corruption clause gives sweeping powers to the Center to discontinue funds if any evidence of corruption is found after investigation by any agency designated by it."

Rural Jobs Plan Threatens fiscal deficit

17. (C) Economists are concerned that the scheme's gigantic cost (as much as USD 70 billion over 5 years) has the potential to widen the fiscal deficit, push up interest rates and hurt the bond market. According to a well-known economist and fund manager Surjit Bhalla, "The consequences for Indian public finances would be huge ... and the low-interest regime will be a thing of the past." Prime Minister Singh is also concerned and is quoted saying, "The combined fiscal deficit of the center and states at 10% of the GDP was one of the highest in the world. All those concerned with the governance should pool their experience to ensure that the fiscal health of both the center and state is not jeopardized."

Politics of the Bill

18. (C) The Congress Party wanted to claim ownership of the

NREG Bill to ensure that the Left do not draw political mileage in next year,s Assembly poll and to rebuild Congress' position as India's de facto party of national governance. Buffeted by the Left, Sonia Gandhi boasted that the Congress had taken up cudgels for the poor, calling the passing of the bill was "a historic moment" that fulfilled one of the UPA,s major election manifesto promises. The Left Parties wanted to grab the credit for the Bill so they could tell the people of West Bengal and Kerala that it was the Left, and not the Congress, which was the moving spirit behind the scheme. Sensing the determination of the Congress leadership to push the Bill, the Left and the BJP made the best of the situation by joining the race for credit sharing. One well-respected businessman MP told us the bill was horrid economics, but became a political juggernaut nobody could afford to oppose. In the end, the NREG became the litmus test of the UPA government's ability to delivery tangible economic benefits to the rural poor who perceive themselves as not having shared equally in the benefits of rapid growth.

Activists join hands with Ms. Gandhi

19. (C) Activists in the National Advisory Council have stepped in to fight Ms. Sonia Gandhi,s political battle. Proponents of the scheme commented "the NREG is one of the most daring and important initiatives of collective responsibility in the world today. If the argument against is that India cannot afford this kind of expenditure the argument must be fought politically. By giving the poor a small measure of dignity and the opportunity to contribute their labor, we only offer a fraction of the entitlements the privileged enjoy." While accepting that corruption has been a major problem in the past with such schemes, including the food for work program, these NAC members argue that the newly passed Right To Information Bill could be used as an effective tool to check the manipulations of the muster-roll.

Politics of Bribery

10. (C) Passed with unusual urgency, the Bill is the most ambitious and uneconomic anti-poverty programs in the history of India. Critics say that what benefit is delivered will go to richer households who exploit the system to boost their incomes, as has happened with a similar scheme in Maharashtra. We believe that the scheme could help improve employment trends and increase rural consumption marginally, but do not expect a significant economic impact on rural poverty alleviation or rural infrastructure development. The benefit will accrue more to the politically needy and savvy than the economically needy.

11. (C) Nevertheless, passage of the NREG is a pre-condition to advance economic reform put forward by the "economists" in government, led by Prime Minister Singh. Singh has made delivery of funding for the NREG conditional on sustained growth at eight percent. If the government sticks to this position (which may well be doubtful down the road), further economic liberalization will be required as the price for fully implementing the NREG. In India, the politics of bribery go hand in hand with the politics of economic reform, with real progress possible only if a balance can be struck between parochial party interests and reformist elements of the complicated NDA coalition.

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